

## **Rural Prosperity White Paper: *Rules of Trade and Market Access***

David L. Franklin  
Sigma One Corporation  
December 20, 2001

### ***Introduction***

Poor people in rural Latin America are poor because the market value of their assets (human capital, physical capital and financial capital) is low and because their opportunities to augment these assets continue to be low, as well. As a result of these conditions, the returns to investments by the poor in their human and physical capital, including technologies to augment the productivity of these assets, has remained low. The rural poor are also faced with recurring natural and economic shocks that tend to deplete the stocks of their meager assets or to lower the value of the output generated by rural families in seeking their livelihoods. The topic for this essay is the role of “Rules of Trade and Market Access”, within an increasingly integrating global market place, in creating opportunities for improved livelihoods of poor people in rural Latin America. As such, it focuses on the role of economic incentives (markets, institutions and policies) in determining the opportunities for augmentation of human and other capital by poor people to enhance the quality of their livelihoods.

As poor people seek to improve the basis for their livelihoods in the context of meager assets and limited market opportunities in the face of uncertainties of nature and economic conditions, they are often limited in their choices. Yet their choices are optimal responses to the opportunities, constraints and risks that they perceive given their experience and the available information in the relevant markets (labor, inputs and products). This essay addresses the potential for policies and institutional arrangements regarding the “Rules of Trade and Market Access” under the WTO and FTAA initiatives, as well as other ongoing processes for global and regional market integration to improve the incentives for asset augmentation by poor rural people in Latin America. Such asset augmentation is the basis for future prosperity and improvements in the quality of the livelihoods of poor rural people in a sustainable and secure perspective. The essay is, therefore, centered on rural households where family members seek to improve the quality of life for themselves and the other members of the household (including children) in terms of their current and future well being. This view recognizes that this quest for well-being is dynamic and involves multiple economic activities by members of poor households, including the augmentation of human capital through nurturing, educational and health activities, other household production activities, participation in labor markets (local, regional and international), and in the production of goods and services for sale in markets (this includes as an important subset the production and sale of agricultural products or their derivatives). The framework for the essay is to assess the potential for “Rules of Trade and Market Access” to enhance the opportunities for poor rural people to achieve higher and more secure returns in each of these

multiple (livelihood) activities—household production, labor force participation and production for markets. These higher returns are necessary for asset augmentation and, thus, for prosperity.

### ***Rules of Trade and Market Access Effects: A Definition***

For the purposes of the “Rural Prosperity White Paper” and this essay, “*Rules of Trade and Market Access*” are defined as the set of policies and institutional arrangements in domestic and international markets that would cause the actual or potential economic value of activities by poor rural persons (as entrepreneurs and/or workers) to diverge from the value that might obtain in efficient markets without policy or institutionally induced distortions. While these latter (efficient markets) conditions seldom obtain fully in practice, they can serve as a norm for judging progress from a more intervened set of market conditions to one where fewer policy and institutional interventions affect the allocation of resources and the movement of goods, capital and persons across space and time. The policies and institutional arrangements of interest may be those of the domestic economy in which the rural household operates, those of countries with the potential to serve as destination markets for the products that embody the value generated by poor rural households and/or transnational arrangements such as the WTO and FTAA.

The policies and institutional arrangements of concern include explicit trade policies of LAC countries as they trade with each other and with the rest of the world, as well as the myriad of other policies and institutional arrangements that affect the composition of output in an economy and the relative incentives between exportables, import substitutes and non-traded goods and services. This latter can involve domestic or international sanitary and phyto-sanitary regulations and standards, product labeling requirements, registration and sanctioning regulations for firms and professionals in specific sectors, systems for registering and enforcing rights to intellectual and other types of property, contract enforcement, investment regulations, export promotion and specific programs to foment the development of specific sectors within economies, etc. While macro-economic and financial policies and institutional arrangements can have important and sometimes dominant effects on the volume, composition and vocation of an economy’s output, this essay does not address these unless they have a proximal nexus with the output that directly embodies the value generated by the rural poor.

Some of the specific rules of trade and market access that are addressed include:

1. Domestic Import Tariffs on Inputs or Equipment
2. Reference Price Mechanisms for Intra-regional Trade in Food Commodities
3. Domestic Food Safety and Phyto-sanitary Standards
4. Rich Country Food Safety and Phyto-sanitary Requirements
5. International Standards Organizations
6. Domestic Customs Valuation and Administration Practices
7. Compliance with WTO Commitment
8. Trade-related Intellectual Property Rights

## 9. Trade-related Investment Measures

### *How Rules of Trade and Market Access Relate to Rural Prosperity*

Within the framework for this essay, poor people are compensated for their efforts by the prevailing market valuation of the products and services produced, whether these are in fact sold in the market or used within the household. This framework treats poor households as “pluri-active” firms that may produce goods and services for sale in the market, may sell labor services outside the household (including local, regional or international labor markets) and also produce goods and services for consumption and investment within the household. The goods and services produced within the household in a given period of time may represent consumption or investment in human capital (or augmentation of other assets) that will be embodied in future output by the household (as products or as labor services). It is the excess or shortfall of the household’s current output over the consumption for basic needs that creates the opportunity (or need) to augment (or deplete) the household’s stock of human and other capital.

“Rules of Trade and Market Access ” affect the valuation of the households activities whether or not the household participates in any market directly linked to the global economy. In fact, the more isolated a household appears from global economic forces (international prices)<sup>1</sup>, the more it has been affected by distortions in the “Rules of Trade and Market Access ”, not less.

“Rules of Trade and Market Access ” can affect the prices (or wages) received by poor households for their effort as a result of direct or implicit tariffs or subsidies to the goods produced by the households or the goods produced by the firms (or other households) to which the poor rural households sell their labor services as wage workers. For example, subsidies to basic grains in rich countries cause excess supplies (in the subsidizing countries) that are then sold in world markets at lower prices than would prevail in the absence of such rich country subsidies to basic grains. Farmers and their workers in poorer countries who produce or would have produced such commodities face lower prices (value) for their actual or potential output or work effort. Alternatively, the output of poor households or of the firms that employ poor rural people as workers may face protective tariffs in countries that might otherwise import such output. The result is the same, the opportunity value of output and thus of labor effort by the rural poor is made lower by the “Rules of Trade and Market Access ” that induce divergence of market prices from those that would prevail in a less intervened set of conditions.

---

<sup>1</sup> The author accepts as given that Globalization of Markets that results from the removal of impediments to trade leads to convergence in the factor prices as posited by the factor price equalization theorem; such convergence does not imply convergence of incomes or income distributions across borders, however. As such, globalization based on removal of trade distortions is good for the poor because it creates opportunities for asset augmentation by the poor, but should not be expected to compensate for inequalities arising from prior exploitation or from persistent social distance among groups within countries.

“Rules of Trade and Market Access ” affect the value of poor households’ assets in many indirect ways, as well. Distortions, such as the direct tariffs and subsidies described in the preceding paragraph can affect the prices of substitutes or complements of goods produced with poor households’ effort and of inputs that complement or substitute for human effort in the production of goods and services. This latter effect alters the productivity of labor and therefore of earnings of poor persons whether they act as entrepreneurs or wage workers.

In addition to these direct or secondary market effects of the tax and subsidy mechanisms imbedded in the “Rules of Trade and Market Access ”, there are numerous other indirect effects that manifest themselves as economy-wide distortions to the rates of exchange between domestic and international resources and as so-called non-tariff barriers (NTBs). In this essay, we will not address economy-wide effects on the real exchange resulting from “Rules of Trade and Market Access ”, although these often have large negative effects on the well-being of the poor in rural areas (Franklin and Valdés, 1993). We will emphasize NTBs because they remain as a major and as yet relatively unattended area for action in the context of rural prosperity. While there has been substantial progress in most Latin American countries regarding economy-wide and sectoral economic liberalization and some countries have gained substantially from regional “free trade” arrangements, most countries are still burdened by significant non-tariff barriers in their own “Rules of Trade and Market Access ” and they face significant NTBs from their regional and extra-regional trading partners. As a result poor rural households continue to be excluded from the opportunities of globalization, in spite of significant expansion (and diversification) of global and regional trading by the countries in USAID’s LAC Region.

### ***Effects of Globalization and Regional Trade Pacts***

Globalization of trade and the international division of labor that is emerging as a result of lower barriers to the movement of goods, capital and people is intrinsically good for the rural poor of Latin America. Much of the poverty that persists in all sub-regions of the western hemisphere is a consequence of exclusions to poor people from participating fully in product and factor markets, domestically and internationally. While there are many socio/cultural dimensions to such exclusions, and these have long and deep historical roots, economic exclusion has been the result of policies and economic governance that have been persistently biased against the assets and capabilities of poor persons in rural areas. For example, the bias against agriculture imbedded in the import substitution and industrialization (ISI) policies has been well documented (Franklin and Valdés, 1993).

ISI policies had an urban bias because consumers and workers were located near urban centers, and it was logical to establish the protected industries near urban centers. The subsidies and protection to these industries also created a bias against domestic resources as inputs, particularly labor and domestic agricultural products. Furthermore, the structure of protection created rents to the factors employed in the ISI enterprises, and these rents had to be rationed by the State. Such conditions led to explicit or implicit political alliances between urban labor unions, employers and bureaucrats to preserve the privileges created by the ISI policies. These alliances also created pressures to concentrate public services and public investment in urban areas. Together, the ISI

policies and the provision of public services to urban centers at subsidized rates led to stagnant productive output and fiscal imbalances that were unsustainable. These latter led to public indebtedness and inflationary finance. These were the roots underlying the “lost decade” of the eighties.

Casual observers often incorrectly associate the process of globalization with the adjustment consequences of the stabilization and trade liberalization processes which the countries of Latin America would have ultimately had to adopt, regardless of globalization, because they could no longer afford the heavy burden of their urban-biased development policies. The rural poor had benefitted from the ISI strategy only by migrating out of rural areas into the shanty towns (tugurios, favelas, pueblos juvenes, colonias, invasiones, etc.) around the urban centers. There they could sell services and some goods to the urban elites and hope to someday be served by the subsidized water, electricity and other public services. The collapse of ISI from its own inefficiencies and the fiscal crises that accompanied this collapse led to macroeconomic crises and eventually to massive adjustments which had severe effects on the now dislocated rural poor who had become urban poor.

The incorrect perspective on the inexorable integration of global markets expressed itself in the riots in Seattle in 1999. Rural and urban poor will benefit from further globalization if it is based on market-based rules for the allocation of resources. The rich countries of the northern hemisphere have aging populations with massive purchasing power. The sources of this wealth are, now, primarily based on technologies which are intensive in human and financial capital. There exist myriad opportunities for poorer countries with their younger populations to supply the increasing consumption demands of the wealthy residents of the North.

The role of market-based rules of trade and access under the WTO and some of the regional trade arrangements is to enable efficient divisions of labor through “smart partnerships” between large and small enterprises across borders to produce and deliver the goods and services required by the affluent northern populations. This requires meeting market demands for product and service quality characteristics in the volumes and at the times demanded by the market. The rural poor will need help in understanding and responding to these new opportunities, but significant barriers to their full participation still remain. It is not “globalization” that is excluding the rural poor from prosperity, it is that too much of the process of linking markets remains hobbled by a view that trade is a zero sum game. For example, in Latin America, many of the existing trade pacts, such as the Andean Pact, The Central American Common Market and even Mercosur have been organized to distribute access to markets as if these were of fixed size. In fact, several of these intra-regional trading arrangements evolved as instruments of the ISI policies, e.g. the Andean Pact. As such, they are burdened with many vestiges of the past, and they are impediments rather than vehicles for true market liberalization and globalization. Fortunately, the USA led Free Trade Area for the Americas offers opportunities to overcome these interventionist legacies.

### ***Economy-wide Competitiveness and Enterprise-level Competitiveness***

The countries in the LAC Region face globally determined prices in all markets (price takers) whether the particular market is cartelized or not, because no single country can affect the world

prices for the goods in which it trades (imports and exports). Even in commodities like coffee, cocoa and bananas in which individual countries have dominant market shares, attempts by a given country to reduce global supply trying to cause an increase in prices will at best create opportunities for other countries to increase market share. In non-traditional products with so-called niche markets, the existence of high “niche” prices in destination markets have induced other countries in the region and outside the region to enter those markets and to erode “niche market” or seasonal window prices for the non-traditional exports from LAC countries.

This market reality means that while particular countries can experience “comparative” advantage in some commodities for significant periods of time, the strategy for sustainable rural prosperity should avoid a dependence on the existence, let alone the persistence of these markets. Rather, the strategy should be based on a mutually re-enforcing emphasis on economy-wide competitiveness and the competitiveness of enterprises within competitive industrial clusters (Michael Porter, 1990). The Rural Prosperity Strategy and the “Rules of Trade and Market Access” elements within it, in particular should avoid “picking winners”, whether sectors or firms (This was the essence of the failed import substitution and industrialization era). The strategy should continue to support public/private dialogue to promote and sustain economy-wide flexibility in financial markets—macroeconomic stability, fiscal prudence with a trade regime characterized by low, uniform and simple tariffs with a minimum of trade distorting non-tariff barriers. This is the core of economy-wide competitiveness.

The strategy should emphasize support for entrepreneurship and the development of market oriented competitive clusters in recognition that *countries don't compete in markets, enterprises do*. Such an approach emphasizes the role of entrepreneurship in seeking new and higher value markets, in meeting the ever more demanding requirements of such markets with high quality factors of production (skilled workers along with modern inputs and technologies) and through cooperation among competitive firms to ensure the provision of support services and an enabling policy environment. A cluster incorporates the forward and backward linkages of firms. The forward linkages include the marketing, logistics, and distribution system for the products that contain value derived from the efforts of poor rural households whether as workers or as entrepreneurs. The backward linkages involve input supplies, modern technologies, and in some cases, the output from farms and other agricultural enterprises in which poor rural people add value through their skills and effort.

### ***Economic Governance, Rules of Trade and Market Access: Benefits to the Rural Poor***

The role of economic governance regarding “Rules of Trade and Market Access” as they affect the benefits to be derived by the rural poor through increased access and participation in the global marketplace is to maintain a neutral framework of economic incentives and macroeconomic stability. This involves credible tariff and taxation policies (e.g. tariffs and VAT that do not discriminate across sectors or between imports and exports), transparent administrative procedures for needed regulatory functions (labor laws, SPS, IPP, etc.) and fiscal expenditures that do not spillover onto financial and foreign exchange markets to create unstable and unpredictable economic incentives. The poor suffer more from distorted policies and from unstable economic signals. The distortions usually imply that one set of factor owners is being

avored and others are being punished by the policies. The poor seldom if ever have the political clout to appropriate the benefits from policy distortions or the means to avoid the deleterious consequences arising from distortions. There is no free lunch! All subsidies must be financed and high taxes will be avoided through extra-legal means. The result will be fiscal deficits that sooner or later will be monetized and result in inflation. The poor with few assets are seldom able to avoid an inflationary tax, but the rich can through capital flight or the asset accumulation.

Beyond the economy wide deleterious consequences to the poor from bad economic governance, the benefits of specific sectoral distortions will get captured by those in positions of privilege and will serve as a source of public patronage. If the rural poor could benefit from such distortions poverty in rural Mexico would have disappeared long ago since such interventions were the hallmark of the ruling party for close to 70 years.

In addition to benefitting from truly neutral policy frameworks, the rural poor can benefit from the provision of truly public goods that are not appropriable by the rich. Public information on market and weather conditions that is reliable, timely and credible can be of great value to the rural poor. The USAID LAC Strategy for Rural Prosperity can support governments to identify such opportunities and to develop the means to supply such public services, sustainably.

### ***Strategic Priorities for Investment to Promote Rural Prosperity***

The strategic elements that emerge from this perspective in the context of “Rules of Trade and Market Access ” is that the rural poor can be reached by enhancing the competitiveness of the clusters that embody their efforts (value-added) either in the forms of products or labor services. Efforts assisting new and existing enterprises which contain or have the potential to embody value created by the efforts of poor rural persons (as entrepreneurs or workers) should have high relative payoffs. This means assisting their clusters to identify new markets, to maintain current knowledge on market requirements regarding product quality standards, SPS requirements, etc. and assisting them to identify and access the means for meeting these market demand requirements (a demand driven strategy). The strategy would include working with business groups and associations within their supporting industries and institutions to participate in policy dialogue for creating and maintaining a neutral policy environment and an adequate provision of truly public goods. In these two aspects, the strategy implies that helping the rural poor to exit from poverty may involve working with the not so poor and even the rich to strengthen the clusters within which the poor have opportunities to augment the value of their human and other assets. Importantly, the approach requires a strong emphasis on enhancing the quality of human capital in ways that enhance the competitiveness of enterprises. This means problem oriented training and experience in addition to general schooling.

The following table presents an overview of how to incorporate the overall strategic approach for rules of trade and market access and some links to other actions areas to be undertaken by USAID in its LAC Rural Prosperity Initiatives. The specific recommendations apply throughout the hemisphere and sub-regional factors would affect the choice of cluster selected as the impact points but not the overall approach. For example, tourism would be emphasized in the Caribbean

and high value agriculture in Central America and the Andes. Light manufacturing opportunities would be sought throughout.

<b>Opportunities for Enhanced Rural Prosperity: Rules of Trade and Market Access</b>			
<b><i>Rules, Policies and Institutional Arrangements</i></b>	<b><i>Prevailing Conditions in LAC Countries</i></b>	<b><i>Effects on Rural Poor</i></b>	<b><i>Opportunity for USAID/LAC and Partners</i></b>
Domestic Import Tariffs on Inputs or Equipment	Most countries have reduced tariffs, but still use NTBs to limit imports modern inputs	Remaining impediments reduce land and rural labor productivity	Promote policy dialogue toward low uniform and simple tariff regimes
Reference Price Mechanisms for Intra-regional Trade in Food Commodities	In use in most LAC countries members of Andean Pact, CACM or CARICOM for Intra-regional trade in foods	Arbitrariness of application causes food insecurity and unpredictable markets: limits diversification	Assistance to Individual Countries to measure welfare effects as FTAA preparation
Domestic Food Safety and Phyto-sanitary Standards	Certification, labeling, and testing procedures are slow and erratic	Lower food security and lower labor productivity (wages)	Promote science-based harmonization & reciprocity
Rich Country Food Safety and Phyto-sanitary Requirements	EU, Japan and USA Standards have been used to protect rich country producers	Limits employment opportunities for rural workers and farming diversification	Partnership with USTR, APHIS, & FDA to assist LACs to comply
International Standards Organizations	Limited participation and use of ISO, IEC, etc. in manufacturing	Limits market niches and opportunities for contract production	GDA Partnerships with large importers to use in LACs
Domestic Customs Valuation and Administration Practices	Most countries non-compliant with WTO market-based valuations	Creates implicit domestic protection and bias against agriculture	Increase assistance for Customs Modernization using Information Tech.
Compliance with WTO Commitments	Most countries are members but have yet to comply with protocols	Symptom of inward orientation of domestic policies	Support through Public/Private Dialogue
Trade-related Intellectual Property Rights	Insecurity of IPR limits use of modern technologies	Lower land and labor productivity, poor cluster linkages	GDA partnership to provide access to rural enterprises



<b>Opportunities for Enhanced Rural Prosperity: Rules of Trade and Market Access</b>			
Trade-related Investment Measures	Impediments to land use and protection to specific sectors	Prevents “smart partnerships” & links with Global Markets	Support through Public/Private Dialogue

### Bibliography

Anderson, Kym. “Social Policy Dimensions of Economic Integration: Environmental and Labour Standards”. *National Bureau of Economic Research Working Paper Series*, 1996, no. 5702.

Bordo, Michael D. and Marc Flandreau. “Core, Periphery, Exchange Rate Regimes, and Globalization”. *National Bureau of Economic Research Working Paper Series*, 2001, no. 8584.

Bredahl, Maury E. “Harmonizing Phytosanitary and Sanitary Regulations through GATT Negotiations”. *The World Economy*, June 1989.

Dollar, David and Aart Kraay. “Growth is Good for the Poor”. *The World Bank*, March 2000.

The Economist. “An Example in the Andes”. *The Economist*, August 7, 1997.

The Economist. “Join the World”. *The Economist*, December 4, 1997.

The Economist. “Playing Games with Prosperity”. *The Economist*, July 26, 2001.

The Economist. “Seeds Sown for Future Growth”. *The Economist*, November 15, 2001.

The Economist. “Chile and Colombia: Supermodel Angst”. *The Economist*, July 1, 1999.

The Economist. “The Free Society on Trial”. *The Economist*, November 19, 1998.

The Economist. “Who Elected the WTO ?”. *The Economist*, September 27, 2001.

Franklin, D.L. and Alberto Valdés. “Trade Policies, Relative Prices, Real Incomes, and Food Consumption in Peru”. *The Bias Against Agriculture*. Edited by Romeo Bautista and Alberto Valdés. International Center for Economic Growth and ICS Press, San Francisco, 1993

Franklin, D.L. and M.W. Harrell, and J.B. Leonard. “Income Effects of Title II Commodities in Rural Panama”. *American Journal of Agricultural Economics*, February 1987.

Franklin, D.L. and Vial de Valdés. “Estrategias Nutricionales de los Hogares Pobres: Los Pobres Tambien Escogen”. *Cuadernos de Economia*, Agosto 1985.

Franklin, D.L. and M.W. Harrell. "Resource Allocation Decisions in Low-Income Rural Households." *Food policy*, May 1985.

Franklin, D.L. and M.W. Harrell. "Panama: Nutritional Functional Classification Study-Who and Where are the Poor." *Food Policy*, February 1985

Franklin, D.L., G. Appleby, A.G. Keeler, P.F. Mulligan, and M.W. Harrell. "A Case Study of Vegetable Production and Marketing in Western Guatemala." *Research Triangle Institute*, 1980.

Franklin, D.L. and I. Vial de Valdés. "La Demanda por Calorias en Hogares con Niños Desnutridos y el Papel del Tiempo de la Madre." *Cuadernos de Economia*, December 1979. Invited paper to Honor the Nobel Prize for Professor T.W. Schultz.

Franklin, D.L. "Equity and Seed Based Innovations in Tropical Agriculture". Centro Internacional de Agricultura Tropical (unpublished manuscript) June 1978.

Goldberg, Pinelopi Koujianou, and Nina Pavcnik. "Trade Protection and Wages: Evidence from the Colombian Trade Reforms". *National Bureau of Economic Research Working Paper Series*, November 2001, no. 8575.

Henson, Spencer, Rupert Loader, Alan Swinbank, Maury Bredahl, and Nicole Lux. "Impact of Sanitary and Phytosanitary Measures on Developing Countries". *The University of Reading Press*, 2001.

Holthausen, Duncan M. "Input Choices and Uncertain Demand". *American Economic Review*, March 1976, vol. 66, no. 1.

Hummels, David. "Have International Transportation Costs Declined?". *University of Chicago*, July 1999.

Janvry, Alain de and Elizabeth Sadoulet,. "Rural Poverty in Latin America: Determinants and Exit Paths". *Food Policy* 25, 2000.

Krueger, Anne O. "International Economic Organizations, Developing Country Reforms, and Trade". *National Bureau of Economic Research*.

Krueger, Anne O. "Trade and Employment in Developing Countries". *National Bureau of Economic Research*, 1982, vol 1 and 2.

Lopez, R and A. Valdés. "Fighting Rural Poverty in Latin America". *World Bank Working Papers*, 1998.

Porter, Michael. *Competitiveness of Nations*, 1990. The Free Press.

Sachs, Jeffrey. "Nature, Nurture and Growth". *The Economist*, June 12, 1997.

Schultz, T.W. "The Economics of Being Poor: Nobel Lecture (1979)". *Journal of Political Economy*, 1980, vol.88 no. 4.

Schultz, T. W. "The Value of the Ability to Deal with Disequilibria". *Journal of Economic Literature*, 1975, vol. 13.

Scobie, G.M. and D.L. Franklin. "The Impact of Supervised Credit Programmes on Technological Change in Developing Agriculture." *The Australian Journal of Agricultural Economics*, April 1977.

Slaughter, Matthew J. "Trade and Labor-Market Outcomes: What About Developing Countries?". *National Bureau of Economic Research*, July 2000.

Soto, Hernando de. "The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else". *New York, Basic Books*, 2000.

Valdés, A. and D.L. Franklin. "Evaluation of Design Parameters in Cattle Production in the Colombia Llanos." *Economics and the Design of Small Farmer Technology*. Edited by Valdés, Scobie, and Dillon. Iowa State Press, 1979

World Bank. "World Development Report: Attacking Poverty". *The World Bank*, 2000.

World Bank. "Globalization, Growth, and Poverty: Building an Inclusive World Economy". *The World Bank and Oxford University Press*.